



 KCS Country Risk & Threat Advisory

KCS Group Europe
Risk & Threat Advisory Paper

Political Risk Advisory Briefing: The Middle East
April 2020

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Region: Middle East
Population: 411 million
Source: World Population Review

The Middle East has a Possible risk rating of 4

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| 6 Very High | The assorted threats described in the report are almost certain to have a derogatory effect. |
| 5 High | The threats are extremely likely to negatively affect the business. |
| 4 Very Possible | There is a strong likelihood of problems arising in this country. |
| 3 Possible | There is a fair chance of problems arising in this country. |
| 2 Low | There is a low likelihood of any threats impacting business. |
| 1 Very Low | There are virtually no impediments to successful business in this country. |



The regional investment environment and key challenges

A complex, resource rich region

The Middle East is a complex and diverse region, encompassing both more advanced economies (e.g. Israel, the United Arab Emirates, Qatar), as well as countries which have been mired in civil war and could be classified as failed states (e.g. Yemen, Syria, Iraq). At one extreme, the State of Qatar is the richest country in the world measured by *per capita* GDP on a purchasing power parity basis, whilst at the other extreme, Yemen, which was already the poorest country in the Middle East before civil war broke out in 2015, is currently suffering probably the worst humanitarian crisis in the world with its economy devastated and critical infrastructure destroyed.

Whilst the countries of the Middle East account for slightly less than 5% of global GDP and *circa* 6% of the total global population, they are sitting on almost 50% of total proven global oil reserves and almost 40% of proved gas reserves (primarily concentrated in Iran, Saudi Arabia, Qatar, Iraq and the UAE).

The IMF projects a 1.2% contraction in the regional GDP of the Middle East in 2019 in real terms, followed by growth of 2.2% in 2020 and remaining in the 2.0%-2.5% range for the medium term. Whilst most countries in the region are forecast to post moderate real growth in 2019, Iran's economy has entered a steep recession – driven primarily by a tightening of US sanctions – and the country's GDP is expected to contract by as much as 9.5% in real terms this year (following a contraction of 4.8% in 2018).

The Middle East is one of the youngest regions in the world with an estimated 60% of its population under the age of 25. Youth unemployment is a serious issue in a number of countries, with approximately a third of the youth population unemployed in Jordan (36.7%) and Egypt (32.4%), and more than 20% in Iran (28.6%), Saudi Arabia (25.5%) and Turkey (21.3%), according to International Labour Organisation estimates.

Apart from the investment environment, key themes addressed below include: the recent wave of mass protests in Egypt, Iraq, Lebanon and Iran; and the increasingly aggressive behaviour of Iran as an apparent response to the US's policy of "*maximum pressure*".

Wide gulf between top and bottom performers in the region on investment climate and corruption

In the World Bank's recently published 2020 Doing Business survey, which compares business regulations in 190 economies, four out of the top 10 improvers over the year are Middle Eastern countries: Saudi Arabia, Jordan, Bahrain and Kuwait. Saudi Arabia takes the title for most improved economy, rising 30 positions year-on-year to rank 62nd (with its overall score improving by 8.1 points).

Perhaps predictably, there is a significant gap between the top performers, the UAE (ranking 16th with a score of 80.9 out of a maximum 100 points), Turkey (33rd / 76.8 points) and Israel (35th / 76.7 points), and the bottom performers, Yemen (187th / 31.8 points), Syria (176th / 42.0 points) and Iraq (172nd / 44.7 points). However, taken as a whole, Middle Eastern economies raised their average ease of doing business score by almost three percentage points year-on-year, one of the best performances of any region.

There is some evidence of the positive power of the demonstration effect with the good example of the undisputed regional leader, the UAE, apparently having a favourable impact on its Gulf Cooperation Council (GCC) neighbours Saudi Arabia, Bahrain and Kuwait.

In the most recent 2018 Transparency International Corruption Perceptions Index, which surveys 180 countries, the Middle East region, with an average score of 40 out of a maximum 100, comes in above sub-Saharan Africa (average score of 32) and Eastern Europe & Central Asia (average score of 35), but below other regional groups.

Unsurprisingly, there is again a wide gap between the top and bottom performers and a significant correlation between those countries that score well in the ease of doing business survey and those countries experiencing less corruption. The three least corrupt countries – UAE (ranked 23rd), Qatar (33rd) and Israel (34th) – and three most corrupt countries – Syria (178th), Yemen (176th) and Iraq (168th) – largely overlap with the top and bottom three performers in the World Bank's Doing Business survey.

Analysing net foreign direct investment (FDI) inflows as a share of GDP over the past five years shows, some countries with better governance and less corruption (e.g. Israel and the UAE) also enjoy stronger FDI inflows, but there are clearly a number of other factors also at

play as countries such as Lebanon, Jordan and Oman have attracted materially more FDI than a number of countries with better governance and corruption ratings.

A new season of discontent?

Over the past few months, mass protests have erupted in Egypt, Iraq, Lebanon – and most recently in Iran. Whilst protesters' demands differ from country to country, discontent over corruption and poor governance have been a common thread.

- **Egypt:** In September 2019, demonstrations broke out in Cairo and a number of other Egyptian cities, protesting against the regime of President Abdel Fattah el-Sisi (despite the fact that protests have been banned since 2013), with a focus on corruption in the military and the army's role in the economy.
- **Iraq:** Countrywide demonstrations, which commenced in early October 2019, constitute the worst civil unrest in Iraq in over a decade, with people expressing their anger over corruption, weak governance and a lack of jobs. Protests have been brutally suppressed with more than 325 killed and 15,000 wounded to date. At the end of October, Iraq's president announced that new elections were needed as the status quo was "no longer sustainable" and said that the prime minister would step down once a replacement was found.
- **Lebanon:** In late October 2019, Lebanese Prime Minister Saad al-Hariri announced his resignation after nearly a fortnight of nationwide protests against the government and the country's failing political system (which included hundreds of thousands of protestors being assaulted by Hezbollah gangs in central Beirut). Resentment has been building up for several years over corruption and the government's inability to deliver basic services.
- **Iran:** In mid-November 2019, an estimated *circa* 90,000 protestors took to the streets in 100 cities and towns across Iran for several days of protests against a steep increase in petrol prices, in what were the largest demonstrations in the country since 2017. Public buildings across the country were set alight and banks looted, whilst security forces used tear gas and fired live rounds into the air to disperse the demonstrators. Within days, the Iranian government announced it would provide cash payments to more than 70% of the population to compensate for the higher petrol costs.

It is worth noting that all four countries are amongst the weaker countries in the Middle East peer group in terms of governance and corruption, ranking for the most part in the bottom quartile for ease of doing business and in terms of corruption perceptions.

“Maximum pressure” on Iran backfires?

In May 2018, the US announced its withdrawal from the Joint Comprehensive Plan of Action, otherwise known as the "Iran nuclear deal", and in November re-imposed sanctions on Iran, leading to severe restrictions on Iran's oil exports, as well as to severe restrictions on imports. The Trump administration's strategy of "maximum pressure" is intended to change Iran's behaviour, including to curtail its 'hostile' activities (whether direct or through its proxies) in Yemen, Syria, Iraq and elsewhere in the region, as well as to persuade it to open negotiations with the US on a new, tougher nuclear deal. However, this strategy appears to have backfired.

After months of aggressive behaviour, including mine attacks on ships and the seizure of a British-flagged oil tanker, Iran upped the ante in September 2019 by launching – via its proxies in Yemen – missile and drone attacks on the heart of the Saudi economy, targeting its massive Abqaiq oil processing facility, as well as striking the Khurais oilfield. This attack amounted to the greatest disruption to the world's energy supplies in decades, ranking as probably the most serious attack on Gulf energy infrastructure since Saddam Hussein's 1990 invasion of Kuwait. *Inter alia*, this attack demonstrated the weakness of Saudi air defences and the vulnerability of its oil industry infrastructure at a particularly sensitive time, just as Saudi Aramco was preparing to list a portion of its shares in what may be the largest IPO ever.

On the back of the attack on Saudi Arabia, Yemen's Iran-backed Houthi group announced it had also identified dozens of sites in the UAE as possible targets. Furthermore, Iran has cyber-forces capable of disrupting energy, financial and other networks within the region as well as outside it.

To date, this "maximum pressure" strategy appears only to have created greater regional instability and greater unease amongst the US's regional partners.

COVID-19

Like everywhere else in the world, Coronavirus has veered its ugly, infectious head in the Middle East and left a costly mark. All countries in the Middle East are taking this virus seriously and all countries to some extent have enforced measures to slow down and contain the virus. Countries like Israel, who mobilised quickly, have imposed quarantine measures and has halted travel into and out of the country and anyone returning from Europe, the U.S. or China are quarantined immediately. While the response of some countries has been quick and decisive, the region has already begun to suffer the consequences of the virus.

The greatest impact on the Middle East has been on the economy. For example, Gulf states are shutting down sections of their economies, like most international and domestic trade and travel. Already we have seen economies like Iran struggling as coronavirus cases and deaths continue to rise. The rapid spread of the virus, coupled with the devastating consequences of the U.S. sanctions, have led Iran to asking for a \$5 billion loan from the IMF- the first request in 60 years. As one would expect, the oil price war between Russia and Saudi Arabia has exacerbated an already fragile situation in the Middle East, sending the oil prices crashing to their lowest levels in 17 years. As a result of the coronavirus and oil price war, countries in region have announced stimulus packages to calm the nerves of companies based in the Middle East. Saudi Arabia announced a \$32 billion packaged to help businesses and UAE said they would pledge \$34 billion.

The tourism industry of the Middle East has also felt the effects of the virus as all travel to and from the Middle East countries have halted. Although borders are open for the trading of goods and commerce, the virus has still disrupted trade to a damaging extent. Any further disruption is likely to have a catastrophic effect on these already fragile economies.

Even religion cannot escape the virus as religious sites have been forced to close in order to contain the virus. In Iran, the government has suspended visits to mosques in order to stop the spread of the virus, and this measure has been taken in other countries in the Middle East. Saudi Arabia has also followed suit by banning gatherings at mosques and even closed the holy Muslim site of Mecca, although it was partly reopened after it went through a 'a deep clean'.

If there is a silver lining in this pandemic, then it is the decrease in violent conflicts in the region and a decrease in tension as a result of coronavirus. Saudi Arabia has agreed to a cease fire

with Yemeni Houthis rebel militia to form a united front to stop the spread of the virus. Additionally, following Western countries, some countries in the Middle East and North Africa (MENA) have released thousands of political prisoners to try and slow down the virus. Bahrain released roughly 1,500 prisoners, 300 of which were political detainees and Iran, uncharacteristically, has released a staggering 85,000 prisoners some of those being political prisoners. Additionally, ISIL have ordered their personnel to cease operations in Europe, the new epicentre of the virus, because of the speed at which the virus has travelled in the region. So, for the time being, Europe will hopefully not see any ISIL activity.

While these changes will be viewed by many as positive, the region faces a difficult time now and ahead of them. The economic damage caused by the virus could have a significant impact on the countries in the region, especially the ones who are already considered to be failed states.